

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

DOCKET FILE COPY ORIGINAL

OCT 19 '94

In the Matter of) PR Docket No. 94-105
) PR File No. 94-SP3
Petition of the People of the State)
of California and the Public)
Utilities Commission of the State)
of California to Retain State)
Regulatory Authority over)
Intrastate Cellular Service Rates)
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REPLY COMMENTS OF THE CELLULAR CARRIERS ASSOCIATION OF CALIFORNIA
AND COMMENTS ON SUPPLEMENTAL INFORMATION SUBMITTED BY THE PUBLIC
UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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SUMMARY

CCAC has reviewed the supplemental material submitted by the CPUC and concludes that it provides no additional support for the contentions of the CPUC. In fact, the additional material contains two errors, both of which tend to understate the actual cellular rate decreases which have occurred in California. The CPUC continues to ignore the substantial ratepayer benefits provided by discounted rate plans, and refuses to attempt to analyze the rate decreases such plans have achieved. CCAC's own rate study does effectively address rate discounting and proves that there have been substantial rate decreases as a result of competition in the cellular market in California.

CCAC has also responded to the Response of the Cellular Resellers Association. The skeletal response of the CRA provides no basis upon which the Commission may find support for the CPUC Petition as it is completely bereft of argument or evidence. Even CRA's usual arguments criticizing the CCAC rate study and claiming excessive profits and market share for cellular carriers, which have been cited and relied upon by the CPUC in the appendices to its Petition, are replete with errors. As a result, the Commission should not give credence to CRA's arguments in this proceeding.

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Pursuant to the Order Extending Time And Permitting Replies To Revised Petition issued on September 26, 1994 in PR Docket No. 94-105 by the Chief of the Private Radio Bureau of the Federal Communications Commission ("FCC" or "Commission"), the Cellular Carriers Association of California ("CCAC") hereby replies to Comments filed in response to the Petition filed by the Public Utilities Commission of the State of California ("CPUC") to retain state regulatory authority over intrastate cellular service rates. In addition, as permitted by the above-referenced Order, CCAC also

responds to the supplementary material produced by the CPUC in an ex parte submission to the FCC on September 13, 1994.¹

I. The Supplemental Material Provided By The CPUC Further Demonstrates The Flawed Justification For CPUC's Petition

On September 13, 1994, the CPUC provided the FCC with twelve revised pages of the text of its Petition which included statistical references previously redacted, as well as approximately 75 pages of partially unredacted material from appendices I and J of the CPUC Petition by means of an ex parte written communication, without notice to the parties. CCAC has obtained and reviewed this supplemental material and concludes that it does nothing to support the CPUC's contention that continued rate regulation over California cellular carriers is necessary.

The CPUC supplemental material consists primarily of two sets of data. Appendix I includes so-called "rate comparisons and trends" and shows the difference in basic rates between the licensed carriers in selected markets, as well as the changes in the average basic rates for each market in nominal and real dollars. Appendix J addresses individual rate plans for the carriers in the markets selected for analysis by the CPUC, and provides the retail and wholesale rates for each service plan in dollars per minute of use over time. The appendix also discusses the number of customers on each such rate plan over the 1989-1993 time period, but this information was redacted in the original CPUC

¹ Ex Parte Letter from Ellen S. LeVine, Principal Counsel, California Public Utilities Commission to William F. Caton, Acting Secretary, FCC (dated September 13, 1994).

Petition and has not been disclosed in the supplemental data. Finally, the CPUC has filled in statistical references to the data in Appendices I and J in the twelve pages of text which were redacted in the original Petition.

CCAC's review of the supplemental material revealed no significant new support for the CPUC Petition. Indeed, the vast majority of the information in the two appendices was taken directly from publicly filed tariffs of the California cellular carriers. However, the CPUC did make two errors in the calculations and tables contained in the supplemental material, both of which further discredit the CPUC's primary contention that cellular rates are unreasonably high and that there is no evidence of effective rate competition.

First, the CPUC used a less accurate inflation adjustment to convert nominal to real dollars for the rate comparisons in Appendix I. The CPUC uses what it calls a "general" Consumer Price Index (CPI) of 14.2 percent for the time period 1989-1993, admitting that it is unsure of the appropriate inflation index to use.² In contrast, in its study of California cellular rates CCAC's consultant, the accounting firm of Ernst and Young utilized the California-specific CPI, developed by the U.S. Department of Labor Bureau of Statistics, which better reflects the costs incurred by cellular carriers operating in California.³ If the

² Revised Petition at 35, fn 14.

³ See Response of the Cellular Carriers Association of California Opposing the Petition of the Public Utilities Commission of the State of California To

CPUC had applied the California-specific CPI to the time period it studied, a cumulative inflation adjustment of 16.72 percent would have been used to represent inflation between 1989 and 1993. The additional 2.52 percent added to the inflation adjustment would, in turn, have resulted in larger decreases in the real dollar rates per minute of use between 1989 and 1993 shown in Appendix I.

CCAC contends that the real dollar impact of cellular rate decreases is the key indicator which the FCC should consider in determining the reasonableness of rates, as it directly reflects the "affordability" of cellular service for subscribers. Significant decreases in real cellular rates argue strongly for the existence of competitive forces in the cellular markets. Thus, the understatement of such decreases, for example, by underestimating inflation, gives a false impression of the impact of competition.

In contrast, the rate study prepared for CCAC by Ernst & Young did utilize a California-specific CPI, as explained in Appendix B of the CCAC Response. The CCAC study covered a different time period than the CPUC study (1990-1994), and the California-specific CPI over this period was only 11.93 percent. This inflation adjustment is smaller than the 16.72 percent which the CPUC should have used for the 1989-1993 period because inflation was substantially higher in 1989 than in 1994. However, cellular rates generally exhibited little change from 1989 to 1990, and if CCAC had extended its study to include 1989, the impact of the

Retain State Regulatory Authority Over Intrastate Cellular Service Rates, filed September 19, 1994, Appendix B, Attachment A.

additional inflation would be real rate decreases approximately 25 percent greater than those shown in Charts D, E, and F of Appendix B of the CCAC response.⁴ Thus over either of the time periods studied, the real decrease in cellular rates is greater than the CPUC's characterization because the CPUC has underrepresented the effect of inflation in its calculations.

CCAC has also uncovered a second error in the supplementary information provided by the CPUC to the FCC. The CPUC's revised petition states, on page 49, that the lowest available monthly bill for a 120 minute-per-month subscriber in either the Los Angeles or San Francisco markets is \$95 per month. However, using the CPUC's own rate data as provided in its revised Appendix J, CCAC has determined that the lowest monthly bill for a 120-minute-per month subscriber in the above-mentioned MSAs would be only \$84.⁵ Thus, the monthly bill using the lowest rates for a 120-minute user is \$11 lower than stated by the CPUC. While this error of 13% is not in itself dramatic, it nevertheless reinforces the fact that the

⁴ For example, the cellular service rates for medium volume callers decreased by 16.4%, 13.28% and 20.8% in larger, medium and small markets, respectively, between 1990 and 1994. See Appendix B, Charts D, E, and F. Extending the analysis back to 1989 and applying the 16.72 percent inflation adjustment would result in effective real decreases in rates over the 1989-94 time frame of approximately 21%, 18%, and 25.5% respectively. The same would be true of the decreases experienced by high and low volume users as well.

⁵ Indeed, every carrier in these markets has a plan less expensive than \$95 per month. See CPUC Petition, as supplemented, Appendix J, BACTC Standard Plan, GTE Mobilnet Saver Plan, LACTC Convenience Value Plan, and LA SMA Super Value - 80 Plan.

CPUC's ultimate conclusions regarding the competitive state of California's cellular industry are frequently based on inaccurate notions of the state of the California cellular market.

Indeed, the CPUC's entire perception of the cellular industry appears colored by the belief that cellular rates have not fallen. This is based in part upon the CPUC's preoccupation with basic rates (which are the basis for the "rate trends" in Appendix I) and partly upon a misperception of the actual rate data. In the latter category CCAC would include both the understated inflation adjustment, the \$11 per month error in the SF-LA bill, and the fact that the CPUC has never undertaken any serious attempt to analyze trends in the highly competitive and steadily declining discounted rate plans. CCAC has conclusively established that the vast majority of California cellular customers purchase services under such discounted plans.⁶ In both its Decision (D.)94-08-022 and in its Petition, the CPUC merely worries a bit about how difficult it is to determine what value customers place on the special terms and conditions of discounted rate plans, but never gets around to actually documenting the substantial rate decreases in these plans.⁷

The supplemental data provided by the CPUC in Appendix I continues to suffer from this error as it concentrates exclusively on basic rates. Appendix J includes more of the discounted plans, although not all of the plans or all of the markets. However,

⁶ CCAC Response, Appendix B, Charts G, H, and I.

⁷ CPUC Petition at 36-37.

Appendix J fails to provide rate trend calculations. Given the CPUC's unwillingness to address the rate trends for discounted rate plans, the FCC should concentrate on studying the rate data provided in the CCAC rate study. If this study documents substantial rate decreases ranging from 23% to 24.5% for high volume users, 13% to 20.7% for medium volume users, and 12% to 21.5% for low volume users between the years 1990 and 1994. As explained above, if this study were adjusted for inflation over the period studied by the CPUC it would reveal even greater real rate decreases.

II. Reply To Comments of California Resellers Association

Three reseller representatives, California Resellers Association, Cellular Service, Inc., and ComTech, Inc. ("CRA") collectively mustered three pages of supporting comments, where CRA makes the considerable claim that the CPUC's Petition demonstrates market conditions in California would result in unreasonable and discriminatory rates and that cellular carriers must be subjected to continued state regulation in California. There are no facts or objective evidence of any kind presented in support of this assertion. Presumably any supporting arguments CRA possesses were saved for this round of reply comments on the grounds that they were too fragile to withstand the scrutiny of the other parties to this proceeding. CRA's stated foundation for its conclusion

amounts to the mere assertion:

CRA, CSI and ComTech can attest to the validity of the Petition's findings and conclusions.⁸

While CRA has submitted a somewhat barren Response in support of the CPUC's Petition, that is not to say CRA has never unveiled more detailed arguments in other proceedings. Indeed, CRA, CCAC and the cellular carriers have extensively argued the same issues raised in the CPUC Petition in comments and related pleadings filed in the CPUC Investigation 93-12-007. CRA's assertion that the CPUC Petition's findings and conclusions are valid is clearly premised on its view that CCAC and the cellular carriers have not proven that cellular rates have decreased. However, CRA has never effectively rebutted the conclusions of the CCAC rate study.

In various California pleadings CRA has argued that CCAC's study looked at rate plans that were "not real rate plans," noting that CCAC excluded activation charges from its analysis of the effective cost per minute for developed rates. CRA is correct that activation charges were excluded from the CCAC rate study. CCAC's consultant, Ernst & Young, did this consciously because activation charges are frequently waived by most carriers, and because the varying length of cellular service contracts make it difficult to arrive at a useful time period over which to amortize the charge if it is collected. If, for example, an activation charge of \$36 were amortized over three years, the \$1 per month would have a negligible effect on a customer's per-minute charges. In a market

⁸ CRA Comments at 2.

where such charges are routinely waived, inclusion or exclusion of activation charges is not a significant factor, and CRA's criticism merely validates the methodology used by CCAC to design its study.

Indeed, CCAC also deliberately excluded multi-line rate plans from its study, as well as seasonal, weekend, promotional, or limited area plans which are characterized by limitations which make it difficult for the majority of customers to use them⁹. Instead, Ernst & Young determined the "optimal" rate plan or plans for the market in question using a set of rate plans which were widely available to all customers. The "optimal plan" represents the plan which a rational consumer would select in order to minimize his or her bill for the average volume of calls made per month.

CCAC's decision to adopt a conservative methodology and ignore the most heavily discounted (but somewhat restricted) rate plans merely reinforces the validity of the CCAC study's conclusion that there is a substantial overall trend in California towards lower cellular rates for all classes of customers in large, medium and small markets over the 1990 to 1994 time frame. In other words, the study's conclusion is highly reliable because it demonstrates significant rate decreases even without considering the lowest available discounted rates. Cellular customers in

⁹ Of course, a customer who can take advantage of such specialized plan, particularly promotional plans, can receive even greater discounts than those included in CCAC's analysis, indicating again CCAC study is highly likely to have understated the effective decrease in rates experienced in California.

California truly are paying lower rates for cellular service each year.

Traditionally CRA has also supported the CPUC conclusion that cellular carriers exercise market power, frequently on the basis of CRA's allegations that CCAC's method of computing market concentration through the Herfindahl-Hirshchmann Index (HHI) is not as reliable as its own. The CPUC has relied upon the CRA market share analysis in its underlying policy decision, D.94-08-022, which is included in its Petition as an appendix.¹⁰ The CRA HHI computations which are merely based on surveys which recorded the market share "predictions" of wireless industry participants. In contrast CCAC has based its market share calculations upon a competitor's call carrying capacity, in terms of the amount of radio spectrum it holds and the technology it uses.

The Charles River Report ("Report") contained in CCAC's Comments fully justifies why the effective capacity of a wireless provider, as measured by available spectrum adjusted for the mix of digital and analog technologies used to provide wireless services, is a superior to market-penetration forecasts for determining the market share that should be assigned to wireless carriers in measuring market concentration. See Report, CCAC Response, Appendix A, at 8-9. As explained in the Report, if a company has a license to use spectrum to provide wireless service and can readily increase its output, that company's capacity serves as a better gauge of its competitive significance than its current output does.

¹⁰ See CPUC Petition, Appendix N, at 31-32.

Report, *supra* at 6.

The Report notes that the Department of Justice Merger Guidelines allow for the inclusion of such expansion capacity in the market concentration calculation when competitors can place new capacity in service within less than one year without significant sunk costs.¹¹ The Report also explains that it is illogical to assume, as CRA does by using forecasts of market penetration rates, that all providers of wireless services will be operating without excess capacity.

In addition, the Report states that new entrants in the mobile radio services markets who obtain their license by auction or by purchase will have already overcome the principal barrier to entry. "In a market that is experiencing rapid expansion, such as the market for mobile services, this cost may not be significant." Report at 7, see fn. 8.

Additional support for the notion that capacity is a better measure of competitive potential than current or forecasted output comes from the fact that in California even potential future competitors affect the market. Both Nextel and the CPUC itself have criticized the marketing strategies of cellular carriers who are trying to convert customers to 1 to 2 year contracts in anticipation of Nextel's entry into the market, in order to keep customers from changing to alternative wireless providers like

¹¹ U.S. Department of Justice, Antitrust Division and Federal Trade Commission, 1992 Horizontal Merger Guidelines, April 2, 1992, Section 1.32.

Nextel.¹² Thus, emerging technologies are already affecting the pricing behavior of cellular carriers, despite the low or non-existent current market shares of the providers in the CPUC's calculations of concentration levels. To the extent that even potential competition can constrain pricing behavior, current output is of no use in analyzing competition and the superiority of using capacity as a measure of market share is evident.

In supporting the CPUC's conclusion that cellular carrier rates and returns are excessive, CRA has routinely relied upon its own study of revenues and returns in the California cellular market.¹³ These simple calculations are based upon operating expenses and revenues filed in the annual reports carriers are required to file with the CPUC. To the extent CRA's comments in this Docket are based in part on CRA's study of cellular returns, it must be noted that the calculations, and the assumptions underlying them, are seriously flawed and provide no basis whatsoever for any inferences that California cellular carriers have been pricing their service at monopoly levels.

CRA's study is undermined by two major flaws relating to its analysis of the returns earned by cellular carriers. First, the resellers implicitly assume that accounting rates of return are good proxies for economic rates of the measure of profit that is relevant to the issue of monopoly. As the CCAC has noted in I.94-12-007, this assumption is wrong. In a classic article, Franklin

¹² CPUC Petition at 43, 74.

¹³ See CPUC Petition, Appendix N at 50.

M. Fisher and John J. McGowan demonstrated that accounting rates of returns are not a reliable measure of economic rates of return. They conclude that "there is no way in which one can look at accounting rates of return and infer anything about relative economic profitability or, a fortiori, about the presence or absence of monopoly profits." ¹⁴

The Charles River Report explained that the economic rate of return on an investment is the discount rate that equates the present value of the investments expected net revenue stream to the initial outlay. Report, *supra* at 22. Accounting rates of return, on the other hand, are calculated by dividing profits earned in a particular year by a measure of the value of a firm's capital assets in that year. But profits in a particular year represent the returns from investments made in past years, while current investments will generate returns in future years and not merely (if at all) in the current year. This mismatching of profits and the investments necessary to generate them reveals nothing about whether a firm is earning monopoly returns on its investments.¹⁵

¹⁴ Franklin M. Fisher and John J. McGowan, "On the Misuse of Accounting Rates of Return to Infer Monopoly Profits", 73 American Economic Review (March 1983) 82-97.

¹⁵ For a fuller discussion of the conceptual problems involved in using accounting rates of return to draw inferences about monopoly profits, see Franklin M. Fisher, John J. McGowan, and Joel E. Greenwood, "Folded, Spindled, and Mutilated: Economic Analysis and U.S. v. I.B.M.", (Cambridge: MIT Press, 1983), pp. 238-242.

The second flaw in CRA's study is that it calculates the cellular carriers' rates of return by relating profits to the net book value of their plant, which is only part of the carriers' investment. CRA ignores the scarcity value of the electromagnetic spectrum is omitted, apparently on the (incorrect) grounds the license to use the spectrum has value only if the cellular carriers have monopoly power.¹⁶ The Charles River Report discredits this practice because significantly overstates carriers actual earnings. See Report, *supra* at 23-25.

III. Conclusion


In conclusion, CCAC contends that the CPUC has not provided any valid additional support for its Petition through the supplemental filing. Nor has CRA presented any effective arguments in favor of state rate regulation. The analyses which underlie the

¹⁶ This argument is also advanced by Mr. Selwyn on behalf of the County of Los Angeles. See County of L.A. at 39.

CRA studies are seriously flawed, and they provide no independent support for the CPUC's arguments.

Respectfully submitted,

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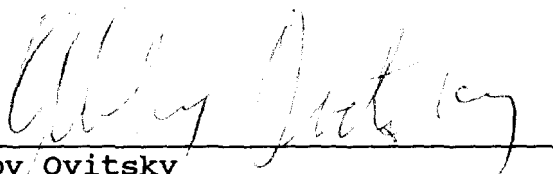
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October 19, 1994

CERTIFICATE OF SERVICE

I, Abby Ovitsky, hereby certify that on this 19th day of October 1994, a true and correct copy of the foregoing **REPLY COMMENTS OF THE CELLULAR CARRIERS ASSOCIATION OF CALIFORNIA AND COMMENTS ON SUPPLEMENTAL INFORMATION SUBMITTED BY THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA** was mailed first class, postage prepaid to the parties listed on the attached service list.



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